

AMENDED IN ASSEMBLY APRIL 24, 2000

AMENDED IN ASSEMBLY APRIL 3, 2000

CALIFORNIA LEGISLATURE—1999–2000 REGULAR SESSION

ASSEMBLY BILL

No. 2461

Introduced by Assembly Members Runner and Cardoza

(Principal coauthor: ~~Assembly Member~~ coauthors:

Assembly Members Cunneen and Machado)

***(Coauthors: Assembly Members Ashburn, Baugh, Briggs,
Campbell, Cox, Dickerson, Leach, Lempert, Longville,
Maddox, Mazzoni, Nakano, Olberg, and Vincent)***

February 24, 2000

An act to amend Sections 17053.49 and 23649 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 2461, as amended, Runner. Income and bank and corporation taxes: MIC.

The Personal Income Tax Law and the Bank and Corporation Tax Law allow to qualified taxpayers a credit against taxes imposed by those laws in an amount equal to 6% of the amount paid or incurred during the taxable or income year for qualified property that is placed in service in this state and, in general, includes specified types of tangible personal property used in connection with manufacturing activities. The credit is allowed to be carried forward for 8 or 9 years, as

applicable, and is repealed as of January 1, 2001, or thereafter, as provided.

This bill would increase the credit to 8%, expand the definition of qualified taxpayer and qualified property to include taxpayers and property related to certain electric power production and the major group of mining and quarrying of nonmetallic minerals, except fuels, ~~allow the credit to be carried forward until it is exhausted,~~ and delete the repeal date, as specified.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 17053.49 of the Revenue and
2 Taxation Code is amended to read:

3 17053.49. (a) (1) A qualified taxpayer shall be
4 allowed a credit against the “net tax,” as defined in
5 Section 17039, equal to 8 percent of the qualified cost of
6 qualified property that is placed in service in this state.

7 (2) In the case of any qualified costs paid or incurred
8 on or after January 1, 1994, and prior to the first taxable
9 year of the qualified taxpayer beginning on or after
10 January 1, 1995, the credit provided under paragraph (1)
11 shall be claimed by the qualified taxpayer on the qualified
12 taxpayer’s return for the first taxable year beginning on
13 or after January 1, 1995. No credit shall be claimed under
14 this section on a return filed for any taxable year
15 commencing prior to the qualified taxpayer’s first taxable
16 year beginning on or after January 1, 1995.

17 (b) (1) For purposes of this section, “qualified cost”
18 means any cost that satisfies each of the following
19 conditions:

20 (A) Except as otherwise provided in this
21 subparagraph, is a cost paid or incurred by the qualified
22 taxpayer for the construction, reconstruction, or
23 acquisition of qualified property on or after January 1,
24 1994, and prior to the date this section ceases to be
25 operative under paragraph (2) of subdivision (i). In the

1 case of any qualified property constructed,
 2 reconstructed, or acquired by the qualified taxpayer (or
 3 any person related to the qualified taxpayer within the
 4 meaning of Section 267 or 707 of the Internal Revenue
 5 Code) pursuant to a binding contract in existence on or
 6 prior to January 1, 1994, costs paid pursuant to that
 7 contract shall be subject to allocation as follows: contract
 8 costs shall be allocated to qualified property based on a
 9 ratio of costs actually paid prior to January 1, 1994, and
 10 total contract costs actually paid. "Cost paid" shall
 11 include, without limitation, contractual deposits and
 12 option payments. To the extent of costs allocated,
 13 whether or not currently deductible or depreciable for
 14 tax purposes, to a period prior to January 1, 1994, the cost
 15 shall be deemed allocated to property acquired before
 16 January 1, 1994, and is thus not a "qualified cost."

17 (B) Except as provided in paragraph (3) of subdivision
 18 (d) and subparagraph (B) of paragraph (4) of subdivision
 19 (d), is an amount upon which the qualified taxpayer has
 20 paid, directly or indirectly, as a separately stated contract
 21 amount or as determined from the records of the
 22 qualified taxpayer, sales or use tax under Part 1
 23 (commencing with Section 6001).

24 (C) Is an amount properly chargeable to the capital
 25 account of the qualified taxpayer.

26 (2) (A) For purposes of this subdivision, any contract
 27 entered into on or after January 1, 1994, that is a successor
 28 or replacement contract to a contract that was binding
 29 prior to January 1, 1994, shall be treated as a binding
 30 contract in existence prior to January 1, 1994.

31 (B) If a successor or replacement contract is entered
 32 into on or after January 1, 1994, and the subject of the
 33 successor or replacement contract relates both to
 34 amounts for the construction, reconstruction, or
 35 acquisition of qualified property described in the original
 36 binding contract and to costs for the construction,
 37 reconstruction, or acquisition of qualified property not
 38 described in the original binding contract, then the
 39 portion of those amounts described in the successor or
 40 replacement contract that were not described in the

1 original binding contract shall not be treated as costs paid
2 or incurred pursuant to a binding contract in existence on
3 or prior to January 1, 1994, under subparagraph (A) of
4 paragraph (1).

5 (3) (A) For purposes of this section, an option
6 contract in existence prior to January 1, 1994, under which
7 a qualified taxpayer (or any other person related to the
8 qualified taxpayer within the meaning of Section 267 or
9 707 of the Internal Revenue Code) had an option to
10 acquire qualified property, shall be treated as a binding
11 contract under the rules in paragraph (2). For purposes
12 of this subparagraph, an option contract shall not include
13 an option under which the optionholder will forfeit an
14 amount less than 10 percent of the fixed option price in
15 the event the option is not exercised.

16 (B) For purposes of this section, a contract shall be
17 treated as binding even if the contract is subject to a
18 condition.

19 (4) For purposes of this subdivision, in the case of any
20 qualified taxpayer engaged in those lines of business
21 described in Codes 7371 to 7373, inclusive, of the Standard
22 Industrial Classification (SIC) Manual published by the
23 United States Office of Management and Budget, 1987
24 edition, “the first taxable year beginning on or after
25 January 1, 1998,” shall be substituted for “January 1, 1994,”
26 in each place in which it appears.

27 (c) (1) For purposes of this section, “qualified
28 taxpayer” means any taxpayer engaged in those lines of
29 business described in Codes 2011 to 3999, inclusive, Codes
30 1411 to 1499, inclusive, Code 4911 (except any taxpayer
31 holding a Certificate of Public Convenience and
32 Necessity issued by the California Public Utilities
33 Commission), or Codes 7371 to 7373, inclusive, of the
34 Standard Industrial Classification (SIC) Manual
35 published by the United States Office of Management
36 and Budget, 1987 edition.

37 (2) In the case of any passthrough entity, the
38 determination of whether a taxpayer is a qualified
39 taxpayer under this section shall be made at the entity
40 level and any credit under this section or Section 23649

shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as any of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 1411 to 1499, inclusive, Codes 2011 to 3999, inclusive, and Code 4911, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, extracting, or recycling of property, or generation of electricity, beginning at the point at which any raw materials are obtained or received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, extracting, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

(C) To maintain, repair, measure, or test any property described in this paragraph.

(D) For pollution control that meets or exceeds standards established by the state or by any local or regional governmental agency within the state.

(E) For recycling.

1 (2) Computers and computer peripheral equipment,
2 as defined in Section 168(i)(2)(B) of the Internal
3 Revenue Code, that is tangible personal property as
4 defined in Section 1245(a) of the Internal Revenue Code
5 for use by a qualified taxpayer in those lines of business
6 described in SIC Codes 7371 to 7373, inclusive, of the SIC
7 Manual, 1987 edition, that is primarily used to develop or
8 manufacture prepackaged software or custom software
9 prepared to the special order of the purchaser who uses
10 the program to produce and sell or license copies of the
11 program as prepackaged software.

12 (3) The value of any capitalized labor costs that are
13 directly allocable to the construction or modification of
14 property described in paragraph (1) or (2).

15 (4) In the case of any qualified taxpayer engaged in
16 manufacturing activities described in SIC Code 357 or
17 367, those activities related to biotechnology described in
18 SIC Code 8731, those activities related to
19 biopharmaceutical establishments only that are
20 described in SIC Codes 2833 to 2836, inclusive, those
21 activities related to space vehicles and parts described in
22 SIC Codes 3761 to 3769, inclusive, those activities related
23 to space satellites and communications satellites and
24 equipment described in SIC Codes 3663 and 3812 (but
25 only with respect to “qualified property” that is placed in
26 service on or after January 1, 1996), or those activities
27 related to semiconductor equipment manufacturing
28 described in SIC Code 3559 (but only with respect to
29 “qualified property” that is placed in service on or after
30 January 1, 1997), “qualified property” also includes the
31 following:

32 (A) Special purpose buildings and foundations that are
33 constructed or modified for use by the qualified taxpayer
34 primarily in a manufacturing, processing, refining, or
35 fabricating process, or as a research or storage facility
36 primarily used in connection with a manufacturing
37 process.

38 (B) The value of any capitalized labor costs that are
39 directly allocable to the construction or modification of
40 special purpose buildings and foundations that are used

1 primarily in the manufacturing, processing, refining, or
2 fabricating process, or as a research or storage facility
3 primarily used in connection with a manufacturing
4 process.

5 (C) (i) For purposes of this paragraph, “special
6 purpose building and foundation” means only a building
7 and the foundation immediately underlying the building
8 that is specifically designed and constructed or
9 reconstructed for the installation, operation, and use of
10 specific machinery and equipment with a special
11 purpose, which machinery and equipment, after
12 installation, will become affixed to or a fixture of the real
13 property, and the construction or reconstruction of which
14 is specifically designed and used exclusively for the
15 specified purposes as set forth in subparagraph (A)
16 (“qualified purpose”).

17 (ii) A building is specifically designed and constructed
18 or modified for a qualified purpose if it is not economical
19 to design and construct the building for the intended
20 purpose and then use the structure for a different
21 purpose.

22 (iii) For purposes of clause (i) and clause (vi), a
23 building is used exclusively for a qualified purpose only if
24 its use does not include a use for which it was not
25 specifically designed and constructed or modified.
26 Incidental use of a building for nonqualified purposes
27 does not preclude the building from being a special
28 purpose building. “Incidental use” means a use which is
29 both related and subordinate to the qualified purpose. It
30 will be conclusively presumed that a use is not
31 subordinate if more than one-third of the total usable
32 volume of the building is devoted to a use which is not a
33 qualified purpose.

34 (iv) In the event an entire building does not qualify as
35 a special purpose building, a taxpayer may establish that
36 a portion of a building, and the foundation immediately
37 underlying the portion, qualifies for treatment as a special
38 purpose building and foundation if the portion satisfies all
39 of the definitional provisions in this subparagraph.

1 (v) To the extent that a building is not a special
2 purpose building as defined above, but a portion of the
3 building qualifies for treatment as a special purpose
4 building, then all equipment which exclusively supports
5 the qualified purpose occurring within that portion and
6 which would qualify as Internal Revenue Code Section
7 1245 property if it were not a fixture or affixed to the
8 building shall be treated as a cost of the portion of the
9 building which qualifies for treatment as a special
10 purpose building.

11 (vi) Buildings and foundations which do not meet the
12 definition of a special purpose building and foundation set
13 forth above include, but are not limited to: buildings
14 designed and constructed or reconstructed principally to
15 function as a general purpose manufacturing, industrial,
16 or commercial building; research facilities that are used
17 primarily prior to or after, or prior to and after, the
18 manufacturing process; or storage facilities that are used
19 primarily prior to or after, or prior to and after,
20 completion of the manufacturing process. A research
21 facility shall not be considered to be used primarily prior
22 to or after, or prior to and after, the manufacturing
23 process if its purpose and use relate exclusively to the
24 development and regulatory approval of the
25 manufacturing process for specific biopharmaceutical
26 products. A research facility which is used primarily in
27 connection with the discovery of an organism from which
28 a biopharmaceutical product or process is developed does
29 not meet the requirements of the preceding sentence.

30 (5) Subject to the provisions in subparagraph (B) of
31 paragraph (1) of subdivision (b), qualified property also
32 includes computer software that is primarily used for
33 those purposes set forth in paragraph (1) or (2) of this
34 subdivision.

35 (6) Qualified property does not include any of the
36 following:

37 (A) Furniture.

38 (B) Facilities used for warehousing purposes after
39 completion of the manufacturing process.

40 (C) Inventory.

(D) Equipment used in the extraction process, *except equipment used for extraction processes described in SIC Codes 1400 to 1499, inclusive.*

(E) Equipment used to store finished products that have completed the manufacturing process.

(F) Any tangible personal property that is used in administration, general management, or marketing.

(G) Any vehicle for which a credit is claimed pursuant to Section 17052.11 or 23603.

(e) For purposes of this section:

(1) “Biopharmaceutical activities” means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

(2) “Fabricating” means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(3) “Manufacturing” means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(4) “Other biotechnology activities” means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(5) “Primarily” means tangible personal property used 50 percent or more of the time in an activity described in subdivision (d).

1 (6) “Process” means the period beginning at the point
2 at which any raw materials are received by the qualified
3 taxpayer and introduced into the manufacturing,
4 processing, refining, fabricating, or recycling activity of
5 the qualified taxpayer and ending at the point at which
6 the manufacturing, processing, refining, fabricating, or
7 recycling activity of the qualified taxpayer has altered
8 tangible personal property to its completed form,
9 including packaging, if required. Raw materials shall be
10 considered to have been introduced into the process
11 when the raw materials are stored on the same premises
12 where the qualified taxpayer’s manufacturing,
13 processing, refining, or recycling activity is conducted.
14 Raw materials that are stored on premises other than
15 where the qualified taxpayer’s manufacturing,
16 processing, refining, fabricating, or recycling activity is
17 conducted, shall not be considered to have been
18 introduced into the manufacturing, processing, refining,
19 fabricating, or recycling process.

20 (7) “Processing” means the physical application of the
21 materials and labor necessary to modify or change the
22 characteristics of property.

23 (8) “Refining” means the process of converting a
24 natural resource to an intermediate or finished product.

25 (9) “Research and development” means those
26 activities that are described in Section 174 of the Internal
27 Revenue Code or in any regulations thereunder.

28 (10) “Small business” means a qualified taxpayer that
29 meets any of the following requirements during the
30 taxable year for which the credit is allowed:

31 (A) Has gross receipts of less than fifty million dollars
32 (\$50,000,000).

33 (B) Has net assets of less than fifty million dollars
34 (\$50,000,000).

35 (C) Has a total credit of less than one million dollars
36 (\$1,000,000).

37 (D) For taxable years beginning on or after January 1,
38 1997, is engaged in biopharmaceutical activities or other
39 biotechnology activities that are described in Codes 2833
40 to 2836, inclusive, of the Standard Industrial Classification

1 (SIC) Manual published by the United States Office of
2 Management and Budget, 1987 edition, and has not
3 received regulatory approval for any product from the
4 United States Food and Drug Administration.

5 (f) The credit allowed under subdivision (a) shall
6 apply to qualified property that is acquired by or subject
7 to lease by a qualified taxpayer, subject to the following
8 special rules:

9 (1) A lessor of qualified property, irrespective of
10 whether the lessor is a qualified taxpayer, shall not be
11 allowed the credit provided under subdivision (a) with
12 respect to any qualified property leased to another
13 qualified taxpayer.

14 (2) For purposes of paragraphs (2) and (3) of
15 subdivision (b), “binding contract” shall include any
16 lease agreement with respect to the qualified property.

17 (3) (A) For purposes of determining the qualified
18 cost paid or incurred by a lessee in any leasing transaction
19 that is not treated as a sale under Part 1 (commencing
20 with Section 6001), the following rules shall apply:

21 (i) Except as provided by subparagraph (C) of this
22 paragraph, subparagraphs (A) and (C) of paragraph (1)
23 of subdivision (b) shall not apply.

24 (ii) Except as provided in subparagraph (B) and
25 clause (iii), the “qualified cost” upon which the lessee
26 shall compute the credit provided under this section shall
27 be equal to the original cost to the lessor (within the
28 meaning of Section 18031) of the qualified property that
29 is the subject of the lease.

30 (iii) Except as provided in clause (iv), the
31 requirement of subparagraph (B) of paragraph (1) of
32 subdivision (b) shall be treated as satisfied only if the
33 lessor has made a timely election under either Section
34 6094.1 or subdivision (d) of Section 6244 and has paid sales
35 tax reimbursement or use tax measured by the purchase
36 price of the qualified property (within the meaning of
37 paragraph (5) of subdivision (g) of Section 6006). For
38 purposes of this subdivision and clause (iv), the amount
39 of original cost to the lessor which may be taken into
40 account under clause (ii) shall not exceed the purchase

1 price upon which sales tax reimbursement or use tax has
2 been paid under the preceding sentence or under clause
3 (iv).

4 (iv) With respect to leases entered into between
5 January 1, 1994, and the effective date of this clause, the
6 lessor may elect to pay use tax measured by the purchase
7 price of the property by reporting and paying the tax with
8 the return of the lessor for the fourth calendar quarter of
9 1994. In computing the use tax under the preceding
10 sentence, a credit shall be allowed under Part 1
11 (commencing with Section 6001) for all sales or use tax
12 previously paid on the lease.

13 (B) For purposes of applying subparagraph (A) only,
14 the following special rules shall apply:

15 (i) The original cost to the lessor of the qualified
16 property shall be reduced by the amount of any original
17 cost of that property that was taken into account by any
18 predecessor lessee in computing the credit allowable
19 under this section.

20 (ii) Clause (i) shall not apply in any case where the
21 predecessor lessee was required to recapture the credit
22 provided under this section pursuant to subdivision (g).

23 (iii) For purposes of this section only, in any case
24 where a successor lessor has acquired qualified property
25 from a predecessor lessor in a transaction not treated as
26 a sale under Part 1 (commencing with Section 6001), the
27 original cost to the successor lessor of the qualified
28 property shall be reduced by the amount of the original
29 cost of the qualified property that was taken into account
30 by any lessee of the predecessor lessor in computing the
31 credit allowable under this section.

32 (C) In determining the original cost of any qualified
33 property under this paragraph, only amounts paid or
34 incurred by the lessor on or after January 1, 1994, and
35 prior to the date this section ceases to be operative under
36 paragraph (2) of subdivision (i), shall be taken into
37 account. In the case of any qualified property
38 constructed, reconstructed, or acquired by a lessor
39 pursuant to a binding contract in existence on or prior to
40 January 1, 1994, the allocation rule specified in

1 subparagraph (A) of paragraph (1) of subdivision (b)
2 shall apply in determining the original cost to the lessor
3 of qualified property.

4 (D) Notwithstanding subparagraph (A), in the case of
5 any leasing transaction for which the lessee is allowed the
6 credit under this section and thereafter the lessee (or any
7 party related to the lessee within the meaning of Section
8 267 or 318 of the Internal Revenue Code) acquires the
9 qualified property from the lessor (or any successor
10 lessor) within one year from the date the qualified
11 property is first used by the lessee under the terms of the
12 lease, the lessee's (or related party's) acquisition of the
13 qualified property from the lessor (or successor lessor)
14 shall be treated as a disposition by the lessee of the
15 qualified property that was subject to the lease under
16 subdivision (g).

17 (4) For purposes of determining the qualified cost
18 paid or incurred by a lessee in any leasing transaction that
19 is treated as a sale under Part 1 (commencing with
20 Section 6001), the following rules shall apply:

21 (A) Subparagraph (A) of paragraph (1) of subdivision
22 (b) shall be applied by substituting the term "purchase"
23 for the term "construction, reconstruction, or
24 acquisition."

25 (B) Subparagraph (C) of paragraph (1) of subdivision
26 (b) shall apply.

27 (C) The requirement of subparagraph (B) of
28 paragraph (1) of subdivision (b) shall be treated as
29 satisfied at the time that either the lessor or the qualified
30 taxpayer pays sales or use tax under Part 1 (commencing
31 with Section 6001).

32 (5) (A) In the case of any leasing transaction
33 described in paragraph (3), the lessor shall provide a
34 statement to the lessee specifying the amount of the
35 lessor's original cost of the qualified property and the
36 amount of that cost upon which a sales or use tax was paid
37 within 45 days after the close of the lessee's taxable year
38 in which the credit is allowable to the lessee under this
39 section.

1 (B) The statement required under subparagraph (A)
2 shall be made available to the Franchise Tax Board upon
3 request.

4 (6) For purposes of this subdivision, in the case of any
5 qualified taxpayer engaged in those lines of business
6 described in Codes 7371 to 7373, inclusive, of the Standard
7 Industrial Classification (SIC) Manual published by the
8 United States Office of Management and Budget, 1987
9 edition, “the first taxable year beginning on or after
10 January 1, 1998,” shall be substituted for “January 1, 1994,”
11 in each place in which it appears. In addition, “the
12 effective date of this paragraph” shall be substituted for
13 “the effective date of this clause” and “fourth calendar
14 quarter of 1998” shall be substituted for “fourth calendar
15 quarter of 1994.”

16 (g) No credit shall be allowed if the qualified property
17 is removed from the state, is disposed of to an unrelated
18 party, or is used for any purpose not qualifying for the
19 credit provided in this section in the same taxable year in
20 which the qualified property is first placed in service in
21 this state. If any qualified property for which a credit is
22 allowed pursuant to this section is thereafter removed
23 from this state, disposed of to an unrelated party, or used
24 for any purpose not qualifying for the credit provided in
25 this section within one year from the date the qualified
26 property is first placed in service in this state, the amount
27 of the credit allowed by this section for that qualified
28 property shall be recaptured by adding that credit
29 amount to the net tax of the qualified taxpayer for the
30 taxable year in which the qualified property is disposed
31 of, removed, or put to an ineligible use.

32 (h) In the case where the credit allowed by this section
33 exceeds the “net tax,” the excess may be carried over to
34 reduce the “net tax” in the following year, and
35 succeeding years *as follows*:

36 *(1) Except as provided in paragraph (2), for the seven*
37 *succeeding years if necessary, until the credit is*
38 *exhausted.*

1 (2) *In the case of a small business, for the nine*
2 *succeeding years* if necessary, until the credit is
3 exhausted.

4 (i) The amendments made by Chapter 954 of the
5 Statutes of 1996 shall be operative for taxable years
6 beginning on or after January 1, 1997, except as provided
7 in paragraph (3) of subdivision (d).

8 (j) The amendments made by Chapter 323 of the
9 Statutes of 1998 shall be operative for taxable years
10 beginning on or after January 1, 1998.

11 (k) The amendments to this section by the act adding
12 this subdivision shall apply only to taxable years
13 beginning on or after January 1, ~~2000~~ 2001.

14 SEC. 2. Section 23649 of the Revenue and Taxation
15 Code is amended to read:

16 23649. (a) (1) A qualified taxpayer shall be allowed
17 a credit against the "tax," as defined in Section 23036,
18 equal to 8 percent of the qualified cost of qualified
19 property that is placed in service in this state.

20 (2) In the case of any qualified costs paid or incurred
21 on or after January 1, 1994, and prior to the first income
22 year of the qualified taxpayer beginning on or after
23 January 1, 1995, the credit provided under paragraph (1)
24 shall be claimed by the qualified taxpayer on the qualified
25 taxpayer's return for the first income year beginning on
26 or after January 1, 1995. No credit shall be claimed under
27 this section on a return filed for any income year
28 commencing prior to the qualified taxpayer's first income
29 year beginning on or after January 1, 1995.

30 (b) (1) For purposes of this section, "qualified cost"
31 means any cost that satisfies each of the following
32 conditions:

33 (A) Except as otherwise provided in this
34 subparagraph, is a cost paid or incurred by the qualified
35 taxpayer for the construction, reconstruction, or
36 acquisition of qualified property on or after January 1,
37 1994, and prior to the date this section ceases to be
38 operative under paragraph (2) of subdivision (i). In the
39 case of any qualified property constructed,
40 reconstructed, or acquired by the qualified taxpayer (or

1 any person related to the qualified taxpayer within the
2 meaning of Section 267 or 707 of the Internal Revenue
3 Code) pursuant to a binding contract in existence on or
4 prior to January 1, 1994, costs paid pursuant to that
5 contract shall be subject to allocation as follows: contract
6 costs shall be allocated to qualified property based on a
7 ratio of costs actually paid prior to January 1, 1994, and
8 total contract costs actually paid. "Cost paid" shall
9 include, without limitation, contractual deposits and
10 option payments. To the extent of cost allocated, whether
11 or not currently deductible or depreciable for tax
12 purposes, to a period prior to January 1, 1994, the cost shall
13 be deemed allocated to property acquired before January
14 1, 1994, and is thus not a "qualified cost."

15 (B) Except as provided in paragraph (3) of subdivision
16 (d) and subparagraph (B) of paragraph (4) of subdivision
17 (d), is an amount upon which the qualified taxpayer has
18 paid, directly or indirectly as a separately stated contract
19 amount or as determined from the records of the
20 qualified taxpayer, sales or use tax under Part 1
21 (commencing with Section 6001).

22 (C) Is an amount properly chargeable to the capital
23 account of the qualified taxpayer.

24 (2) (A) For purposes of this subdivision, any contract
25 entered into on or after January 1, 1994, that is a successor
26 or replacement contract to a contract that was binding
27 prior to January 1, 1994, shall be treated as a binding
28 contract in existence prior to January 1, 1994.

29 (B) If a successor or replacement contract is entered
30 into on or after January 1, 1994, and the subject of the
31 successor or replacement contract relates both to
32 amounts for the construction, reconstruction, or
33 acquisition of qualified property described in the original
34 binding contract and to costs for the construction,
35 reconstruction, or acquisition of qualified property not
36 described in the original binding contract, then the
37 portion of those amounts described in the successor or
38 replacement contract that were not described in the
39 original binding contract shall not be treated as costs paid
40 or incurred pursuant to a binding contract in existence on

1 or prior to January 1, 1994, under subparagraph (A) of
2 paragraph (1).

3 (3) (A) For purposes of this section, an option
4 contract in existence prior to January 1, 1994, under which
5 a qualified taxpayer (or any other person related to the
6 qualified taxpayer within the meaning of Section 267 or
7 707 of the Internal Revenue Code) had an option to
8 acquire qualified property, shall be treated as a binding
9 contract under the rules in paragraph (2). For purposes
10 of this subparagraph, an option contract shall not include
11 an option under which the optionholder will forfeit an
12 amount less than 10 percent of the fixed option price in
13 the event the option is not exercised.

14 (B) For purposes of this section, a contract shall be
15 treated as binding even if the contract is subject to a
16 condition.

17 (4) For purposes of this subdivision, in the case of any
18 qualified taxpayer engaged in those lines of business
19 described in Codes 7371 to 7373, inclusive, of the Standard
20 Industrial Classification (SIC) Manual published by the
21 United States Office of Management and Budget, 1987
22 edition, “the first income year beginning on or after
23 January 1, 1998,” shall be substituted for “January 1, 1994,”
24 in each place in which it appears.

25 (c) (1) For purposes of this section, “qualified
26 taxpayer” means any taxpayer engaged in those lines of
27 business described in Codes 1411 to 1499, inclusive, Code
28 4911 (except any taxpayer holding a Certificate of Public
29 Convenience and Necessity issued by the California
30 Public Utilities Commission), Codes 2011 to 3999,
31 inclusive, Code 4911, or Codes 7371 to 7373, inclusive, of
32 the Standard Industrial Classification (SIC) Manual
33 published by the United States Office of Management
34 and Budget, 1987 edition.

35 (2) In the case of any passthrough entity, the
36 determination of whether a taxpayer is a qualified
37 taxpayer shall be made at the entity level and any credit
38 under this section or Section 17053.49 shall be allowed to
39 the passthrough entity and passed through to the partners
40 or shareholders in accordance with applicable provisions

1 of Part 10 (commencing with Section 17001) or Part 11
2 (commencing with Section 23001). For purposes of this
3 paragraph, the term “passthrough entity” means any
4 partnership or S corporation.

5 (3) The Franchise Tax Board may prescribe
6 regulations to carry out the purposes of this section,
7 including any regulations necessary to prevent the
8 avoidance of the effect of this section through splitups,
9 shell corporations, partnerships, tiered ownership
10 structures, sale-leaseback transactions, or otherwise.

11 (d) For purposes of this section, “qualified property”
12 means property that is described as either of the
13 following:

14 (1) Tangible personal property that is defined in
15 Section 1245(a) of the Internal Revenue Code for use by
16 a qualified taxpayer in those lines of business described in
17 Codes 1411 to 1499, inclusive, Codes 2011 to 3999,
18 inclusive, and Code 4911, of the Standard Industrial
19 Classification (SIC) Manual published by the United
20 States Office of Management and Budget, 1987 edition,
21 that is primarily used for any of the following:

22 (A) For the manufacturing, processing, refining,
23 fabricating, extracting, or recycling of property, or
24 generation of electricity, beginning at the point at which
25 any raw materials are obtained or received by the
26 qualified taxpayer and introduced into the process and
27 ending at the point at which the manufacturing,
28 processing, refining, fabricating, extracting, or recycling
29 has altered tangible personal property to its completed
30 form, including packaging, if required.

31 (B) In research and development.

32 (C) To maintain, repair, measure, or test any property
33 described in this paragraph.

34 (D) For pollution control that meets or exceeds
35 standards established by the state or by any local or
36 regional governmental agency within the state.

37 (E) For recycling.

38 (2) Computers and computer peripheral equipment,
39 as defined in Section 168(i)(2)(B) of the Internal
40 Revenue Code, that is tangible personal property as

1 defined in Section 1245(a) of the Internal Revenue Code
2 for use by a qualified taxpayer in those lines of business
3 described in SIC Codes 7371 to 7373, inclusive, of the SIC
4 Manual, 1987 edition, that is primarily used to develop or
5 manufacture prepackaged software or custom software
6 prepared to the special order of the purchaser who uses
7 the program to produce and sell or license copies of the
8 program as prepackaged software.

9 (3) The value of any capitalized labor costs that are
10 directly allocable to the construction or modification of
11 property described in paragraph (1) or (2).

12 (4) In the case of any qualified taxpayer engaged in
13 manufacturing activities described in SIC Code 357 or
14 367, those activities related to biotechnology described in
15 SIC Code 8731, those activities related to
16 biopharmaceutical establishments only that are
17 described in SIC Codes 2833 to 2836, inclusive, those
18 activities related to space vehicles and parts described in
19 SIC Codes 3761 to 3769, inclusive, those activities related
20 to space satellites and communications satellites and
21 equipment described in SIC Codes 3663 and 3812 (but
22 only with respect to “qualified property” that is placed in
23 service on or after January 1, 1996), or those activities
24 related to semiconductor equipment manufacturing
25 described in SIC Code 3559 (but only with respect to
26 “qualified property” that is placed in service on or after
27 January 1, 1997), “qualified property” also includes the
28 following:

29 (A) Special purpose buildings and foundations that are
30 constructed or modified for use by the qualified taxpayer
31 primarily in a manufacturing, processing, refining, or
32 fabricating process, or as a research or storage facility
33 primarily used in connection with a manufacturing
34 process.

35 (B) The value of any capitalized labor costs that are
36 directly allocable to the construction or modification of
37 special purpose buildings and foundations that are used
38 primarily in the manufacturing, processing, refining, or
39 fabricating process, or as a research or storage facility

1 primarily used in connection with a manufacturing
2 process.

3 (C) (i) For purposes of this paragraph, “special
4 purpose building and foundation” means only a building
5 and the foundation immediately underlying the building
6 that is specifically designed and constructed or
7 reconstructed for the installation, operation, and use of
8 specific machinery and equipment with a special
9 purpose, which machinery and equipment, after
10 installation, will become affixed to or a fixture of the real
11 property, and the construction or reconstruction of which
12 is specifically designed and used exclusively for the
13 specified purposes as set forth in subparagraph (A)
14 (“qualified purpose”).

15 (ii) A building is specifically designed and constructed
16 or modified for a qualified purpose if it is not economical
17 to design and construct the building for the intended
18 purpose and then use the structure for a different
19 purpose.

20 (iii) For purposes of clause (i) and clause (vi), a
21 building is used exclusively for a qualified purpose only if
22 its use does not include a use for which it was not
23 specifically designed and constructed or modified.
24 Incidental use of a building for nonqualified purposes
25 does not preclude the building from being a special
26 purpose building. “Incidental use” means a use which is
27 both related and subordinate to the qualified purpose. It
28 will be conclusively presumed that a use is not
29 subordinate if more than one-third of the total usable
30 volume of the building is devoted to a use which is not a
31 qualified purpose.

32 (iv) In the event an entire building does not qualify as
33 a special purpose building, a taxpayer may establish that
34 a portion of a building, and the foundation immediately
35 underlying the portion, qualifies for treatment as a special
36 purpose building and foundation if the portion satisfies all
37 of the definitional provisions in this subparagraph.

38 (v) To the extent that a building is not a special
39 purpose building as defined above, but a portion of the
40 building qualifies for treatment as a special purpose

building, then all equipment which exclusively supports the qualified purpose occurring within that portion and which would qualify as Internal Revenue Code Section 1245 property if it were not a fixture or affixed to the building shall be treated as a cost of the portion of the building which qualifies for treatment as a special purpose building.

(vi) Buildings and foundations which do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to: buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process. A research facility shall not be considered to be used primarily prior to or after, or prior to and after, the manufacturing process if its purpose and use relate exclusively to the development and regulatory approval of the manufacturing process for specific biopharmaceutical products. A research facility which is used primarily in connection with the discovery of an organism from which a biopharmaceutical product or process is developed does not meet the requirements of the preceding sentence.

(5) Subject to the provisions in subparagraph (B) of paragraph (1) of subdivision (b), qualified property also includes computer software that is primarily used for those purposes set forth in paragraph (1) or (2) of this subdivision.

(6) Qualified property does not include any of the following:

(A) Furniture.

(B) Facilities used for warehousing purposes after completion of the manufacturing process.

(C) Inventory.

(D) Equipment used in the extraction process.

(E) Equipment used to store finished products that have completed the manufacturing process.

1 (F) Any tangible personal property that is used in
2 administration, general management, or marketing.

3 (G) Any vehicle for which a credit is claimed pursuant
4 to Section 17052.11 or 23603.

5 (e) For purposes of this section:

6 (1) “Biopharmaceutical activities” means those
7 activities that use organisms or materials derived from
8 organisms, and their cellular, subcellular, or molecular
9 components, in order to provide pharmaceutical
10 products for human or animal therapeutics and
11 diagnostics. Biopharmaceutical activities make use of
12 living organisms to make commercial products, as
13 opposed to pharmaceutical activities which make use of
14 chemical compounds to produce commercial products.

15 (2) “Fabricating” means to make, build, create,
16 produce, or assemble components or property to work in
17 a new or different manner.

18 (3) “Manufacturing” means the activity of converting
19 or conditioning property by changing the form,
20 composition, quality, or character of the property for
21 ultimate sale at retail or use in the manufacturing of a
22 product to be ultimately sold at retail. Manufacturing
23 includes any improvements to tangible personal property
24 that result in a greater service life or greater functionality
25 than that of the original property.

26 (4) “Other biotechnology activities” means activities
27 consisting of the application of recombinant DNA
28 technology to produce commercial products, as well as
29 activities regarding pharmaceutical delivery systems
30 designed to provide a measure of control over the rate,
31 duration, and site of pharmaceutical delivery.

32 (5) “Primarily” means tangible personal property
33 used 50 percent or more of the time in an activity
34 described in subdivision (d).

35 (6) “Process” means the period beginning at the point
36 at which any raw materials are received by the qualified
37 taxpayer and introduced into the manufacturing,
38 processing, refining, fabricating, or recycling activity of
39 the qualified person and ending at the point at which the
40 manufacturing, processing, refining, fabricating, or

1 recycling activity of the qualified taxpayer has altered
2 tangible personal property to its completed form,
3 including packaging, if required. Raw materials shall be
4 considered to have been introduced into the process
5 when the raw materials are stored on the same premises
6 where the qualified taxpayer's manufacturing,
7 processing, refining, fabricating, or recycling activity is
8 conducted. Raw materials that are stored on premises
9 other than where the qualified taxpayer's manufacturing,
10 processing, refining, fabricating, or recycling activity is
11 conducted, shall not be considered to have been
12 introduced into the manufacturing, processing, refining,
13 fabricating, or recycling process.

14 (7) "Processing" means the physical application of the
15 materials and labor necessary to modify or change the
16 characteristics of property.

17 (8) "Refining" means the process of converting a
18 natural resource to an intermediate or finished product.

19 (9) "Research and development" means those
20 activities that are described in Section 174 of the Internal
21 Revenue Code or in any regulations thereunder.

22 (10) "Small business" means a qualified taxpayer that
23 meets any of the following requirements during the
24 income year for which the credit is allowed:

25 (A) Has gross receipts of less than fifty million dollars
26 (\$50,000,000).

27 (B) Has net assets of less than fifty million dollars
28 (\$50,000,000).

29 (C) Has a total credit of less than one million dollars
30 (\$1,000,000).

31 (D) For income years beginning on or after January 1,
32 1997, is engaged in biopharmaceutical activities or other
33 biotechnology activities that are described in Codes 2833
34 to 2836, inclusive, of the Standard Industrial Classification
35 (SIC) Manual published by the United States Office of
36 Management and Budget, 1987 edition, and has not
37 received regulatory approval for any product from the
38 United States Food and Drug Administration.

39 (f) The credit allowed under subdivision (a) shall
40 apply to qualified property that is acquired by or subject

1 to lease by a qualified taxpayer, subject to the following
2 special rules:

3 (1) A lessor of qualified property, irrespective of
4 whether the lessor is a qualified taxpayer, shall not be
5 allowed the credit provided under subdivision (a) with
6 respect to any qualified property leased to another
7 qualified taxpayer.

8 (2) For purposes of paragraphs (2) and (3) of
9 subdivision (b), “binding contract” shall include any
10 lease agreement with respect to the qualified property.

11 (3) (A) For purposes of determining the qualified
12 cost paid or incurred by a lessee in any leasing transaction
13 that is not treated as a sale under Part 1 (commencing
14 with Section 6001), the following rules shall apply:

15 (i) Except as provided by subparagraph (C) of this
16 paragraph, subparagraphs (A) and (C) of paragraph (1)
17 of subdivision (b) shall not apply.

18 (ii) Except as provided in subparagraph (B) and
19 clause (iii), the “qualified cost” upon which the lessee
20 shall compute the credit provided under this section shall
21 be equal to the original cost to the lessor (within the
22 meaning of Section 24912) of the qualified property that
23 is the subject of the lease.

24 (iii) Except as provided in clause (iv), the
25 requirement of subparagraph (B) of paragraph (1) of
26 subdivision (b) shall be treated as satisfied only if the
27 lessor has made a timely election under either Section
28 6094.1 or subdivision (d) of Section 6244 and has paid sales
29 tax reimbursement or use tax measured by the purchase
30 price of the qualified property (within the meaning of
31 paragraph (5) of subdivision (g) of Section 6006). For
32 purposes of this subdivision and clause (iv), the amount
33 of original cost to the lessor which may be taken into
34 account under clause (ii) shall not exceed the purchase
35 price upon which sales tax reimbursement or use tax has
36 been paid under the preceding sentence or under clause
37 (iv).

38 (iv) With respect to leases entered into between
39 January 1, 1994, and the effective date of this clause, the
40 lessor may elect to pay use tax measured by the purchase

price of the property by reporting and paying the tax with the return of the lessor for the fourth calendar quarter of 1994. In computing the use tax under the preceding sentence, a credit shall be allowed under Part 1 (commencing with Section 6001) for all sales or use tax previously paid on the lease.

(B) For purposes of applying subparagraph (A) only, the following special rules shall apply:

(i) The original cost to the lessor of the qualified property shall be reduced by the amount of any original cost of that property that was taken into account by any predecessor lessee in computing the credit allowable under this section.

(ii) Clause (i) shall not apply in any case where the predecessor lessee was required to recapture the credit provided under this section pursuant to subdivision (g).

(iii) For purposes of this section only, in any case where a successor lessor has acquired qualified property from a predecessor lessor in a transaction not treated as a sale under Part 1 (commencing with Section 6001), the original cost to the successor lessor of the qualified property shall be reduced by the amount of the original cost of the qualified property that was taken into account by any lessee of the predecessor lessor in computing the credit allowable under this section.

(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i), shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 1994, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any

1 party related to the lessee within the meaning of Section
2 267 or 318 of the Internal Revenue Code) acquires the
3 qualified property from the lessor (or any successor
4 lessor) within one year from the date the qualified
5 property is first used by the lessee under the terms of the
6 lease, the lessee's (or related party's) acquisition of the
7 qualified property from the lessor (or successor lessor)
8 shall be treated as a disposition by the lessee of the
9 qualified property that was subject to the lease under
10 subdivision (g).

11 (4) For purposes of determining the qualified cost
12 paid or incurred by a lessee in any leasing transaction that
13 is treated as a sale under Part 1 (commencing with
14 Section 6001), the following rules shall apply:

15 (A) Subparagraph (A) of paragraph (1) of subdivision
16 (b) shall be applied by substituting the term "purchase"
17 for the term "construction, reconstruction, or
18 acquisition."

19 (B) Subparagraph (C) of paragraph (1) of subdivision
20 (b) shall apply.

21 (C) The requirement of subparagraph (B) of
22 paragraph (1) of subdivision (b) shall be treated as
23 satisfied at the time that either the lessor or the qualified
24 taxpayer pays sales or use tax under Part 1 (commencing
25 with Section 6001).

26 (5) (A) In the case of any leasing transaction
27 described in paragraph (3), the lessor shall provide a
28 statement to the lessee specifying the amount of the
29 lessor's original cost of the qualified property and the
30 amount of that cost upon which a sales or use tax was paid
31 within 45 days after the close of the lessee's taxable year
32 in which the credit is allowable to the lessee under this
33 section.

34 (B) The statement required under subparagraph (A)
35 shall be made available to the Franchise Tax Board upon
36 request.

37 (6) For purposes of this subdivision, in the case of any
38 qualified taxpayer engaged in those lines of business
39 described in Codes 7371 to 7373, inclusive, of the Standard
40 Industrial Classification (SIC) Manual published by the

1 United States Office of Management and Budget, 1987
2 edition, “the first income year beginning on or after
3 January 1, 1998,” shall be substituted for “January 1, 1994,”
4 in each place in which it appears. In addition, “the
5 effective date of this paragraph” shall be substituted for
6 “the effective date of this clause” and “fourth calendar
7 quarter of 1998” shall be substituted for “fourth calendar
8 quarter of 1994.”

9 (g) No credit shall be allowed if the qualified property
10 is removed from the state, is disposed of to an unrelated
11 party, or is used for any purpose not qualifying for the
12 credit provided in this section in the same taxable year in
13 which the qualified property is first placed in service in
14 this state. If any qualified property for which a credit is
15 allowed pursuant to this section is thereafter removed
16 from this state, disposed of to an unrelated party, or used
17 for any purpose not qualifying for the credit provided in
18 this section within one year from the date the qualified
19 property is first placed in service in this state, the amount
20 of the credit allowed by this section for that qualified
21 property shall be recaptured by adding that credit
22 amount to the net tax of the qualified taxpayer for the
23 taxable year in which the qualified property is disposed
24 of, removed, or put to an ineligible use.

25 (h) In the case where the credit allowed by this section
26 exceeds the “tax,” the excess may be carried over to
27 reduce the “tax” in the following year, and succeeding
28 years *as follows*:

29 (1) *Except as provided in paragraph (2), for the seven*
30 *succeeding years if necessary, until the credit is*
31 *exhausted.*

32 (2) *In the case of a small business, for the nine*
33 *succeeding years if necessary, until the credit is*
34 *exhausted.*

35 (i) The amendments made by Chapter 954 of the
36 Statutes of 1996 shall be operative for income years
37 beginning on or after January 1, 1997, except as provided
38 in paragraph (3) of subdivision (d).

1 (j) The amendments made by Chapter 323 of the
2 Statutes of 1998 shall be operative for income years
3 beginning on or after January 1, 1998.

4 (k) The amendments to this section by the act adding
5 this subdivision shall apply only to income years
6 beginning on or after January 1, ~~2000~~ 2001.

7 SEC. 3. This act provides for a tax levy within the
8 meaning of Article IV of the Constitution and shall go into
9 immediate effect.

